How the FOMC talks

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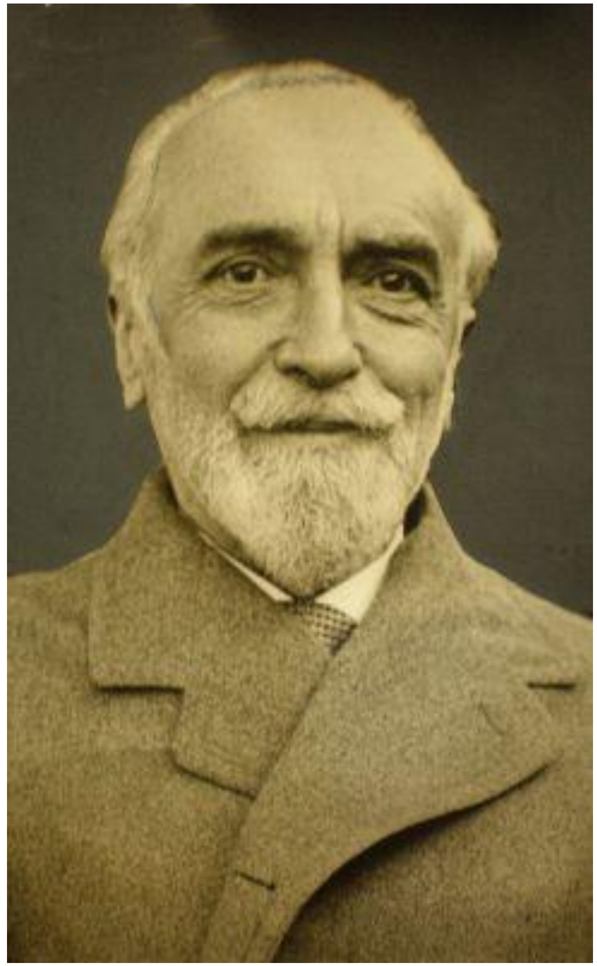
“Never explain. Never excuse.”



Montagu Norman
Governor of the Bank of England, 1920-44

- “Central Banking …thrives on a pervasive impression that [it] …is an esoteric art. Access to this art and its proper execution is confined to the initiated elite. The esoteric nature of the art is moreover revealed by an inherent impossibility to articulate its insights in explicit and intelligible words and sentences.”
  - Karl Brunner, 1981

Fed insider views

- “Such phrases are terms of art that have meaning when read by knowledgeable market participants.”
  - (Fed Governor Robert Holland, 1976)
- “Disclosure of the directive would be more misleading to the market than no information at all.”
  - (SOMA Manager Peter Sternlight, 1980)
- “The FOMC’s ability to formulate effective policy by accurately predicting market reactions would be diminished.”
  - (Fed Governor J. Charles Partee, 1980)

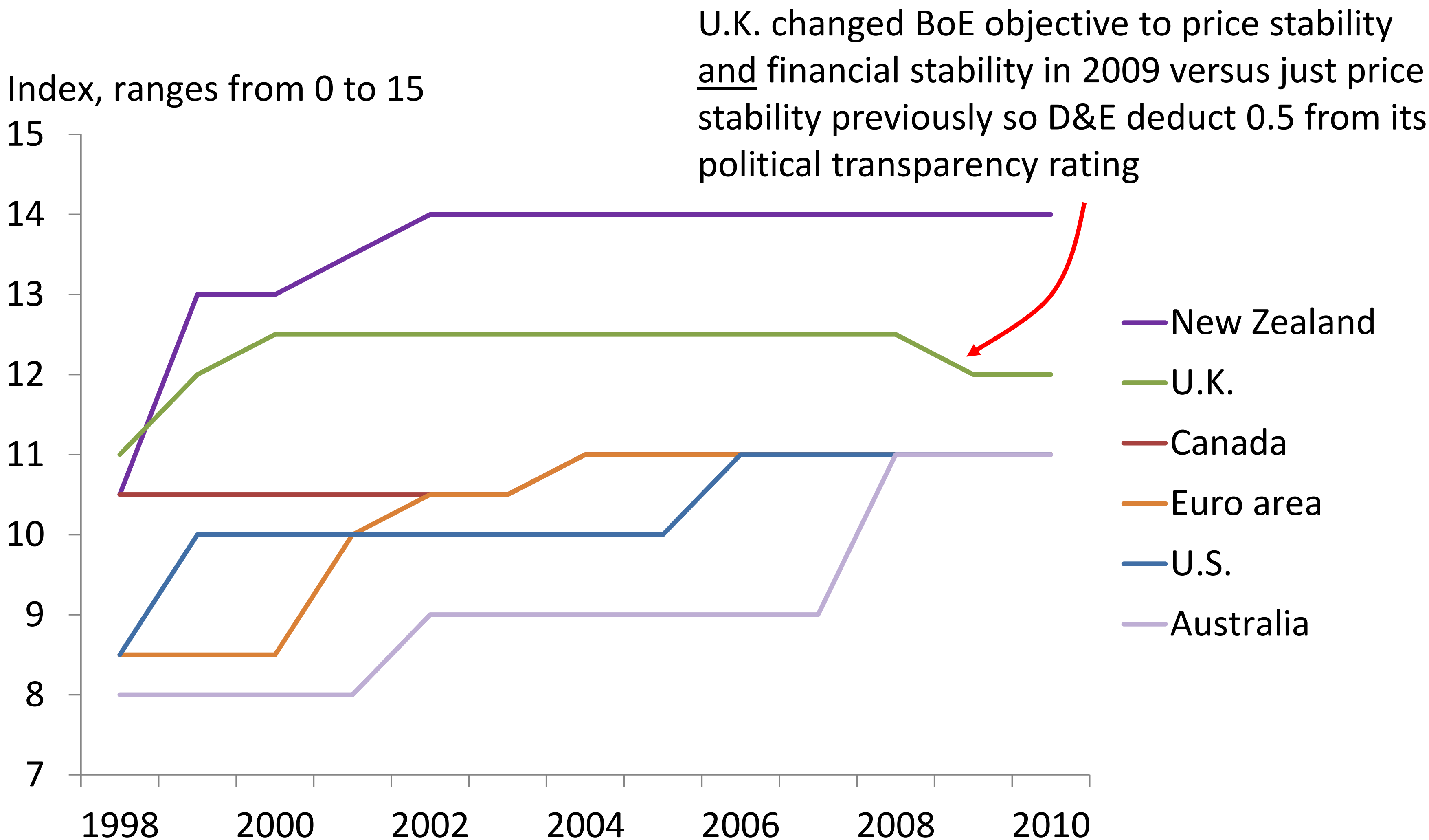
Outline

- The intellectual backdrop
  - 1970s revolution in macroeconomics
- The evolution of FOMC communications
  - Catching up with best practice
- Tradeoffs
  - From saying too little to saying too much?

A revolution in economic thinking

- Great Inflation of the 1970s
  - Breakdown of postwar Keynesian consensus
- New view:
  - How firms and households think about the future is central to how they behave today
- Implication for policy:
  - Policy should be transparent and follow rules
  - Example: Taylor Rule relating interest rates to inflation and the output gap

Evolution of central bank transparency



Federal Reserve Release

Press Release

Release Date: February 4, 1994

For immediate release

Chairman Alan Greenspan announced today that the Federal Open Market Committee decided to increase slightly the degree of pressure on reserve positions. The action is expected to be associated with a small increase in short-term money market interest rates.

The decision was taken to move toward a less accommodative stance in monetary policy in order to sustain and enhance the economic expansion.

Chairman Greenspan decided to announce this action immediately so as to avoid any misunderstanding of the Committee's purposes, given the fact that this is the first firming of reserve market conditions by the Committee since early 1989.

Milestones

- 1995: all <u>changes</u> in monetary policy would be announced immediately
- 1999: release statement after every meeting; specify "target" level of fed funds rate; "forward guidance" in form of balance of risks
- 2002: dissenting votes published immediately
- 2003: forward guidance on policy
  - "…policy accommodation can be maintained for a considerable period."
- 2004: tightening cycle
  - "…policy accommodation can be removed at a pace that is likely to be measured"
- 2008: fed funds rate to 0-¼ percent
  - Time contingent forward guidance
    - "…for an extended period"
    - Changed to "…at least through mid-2013" in 2011

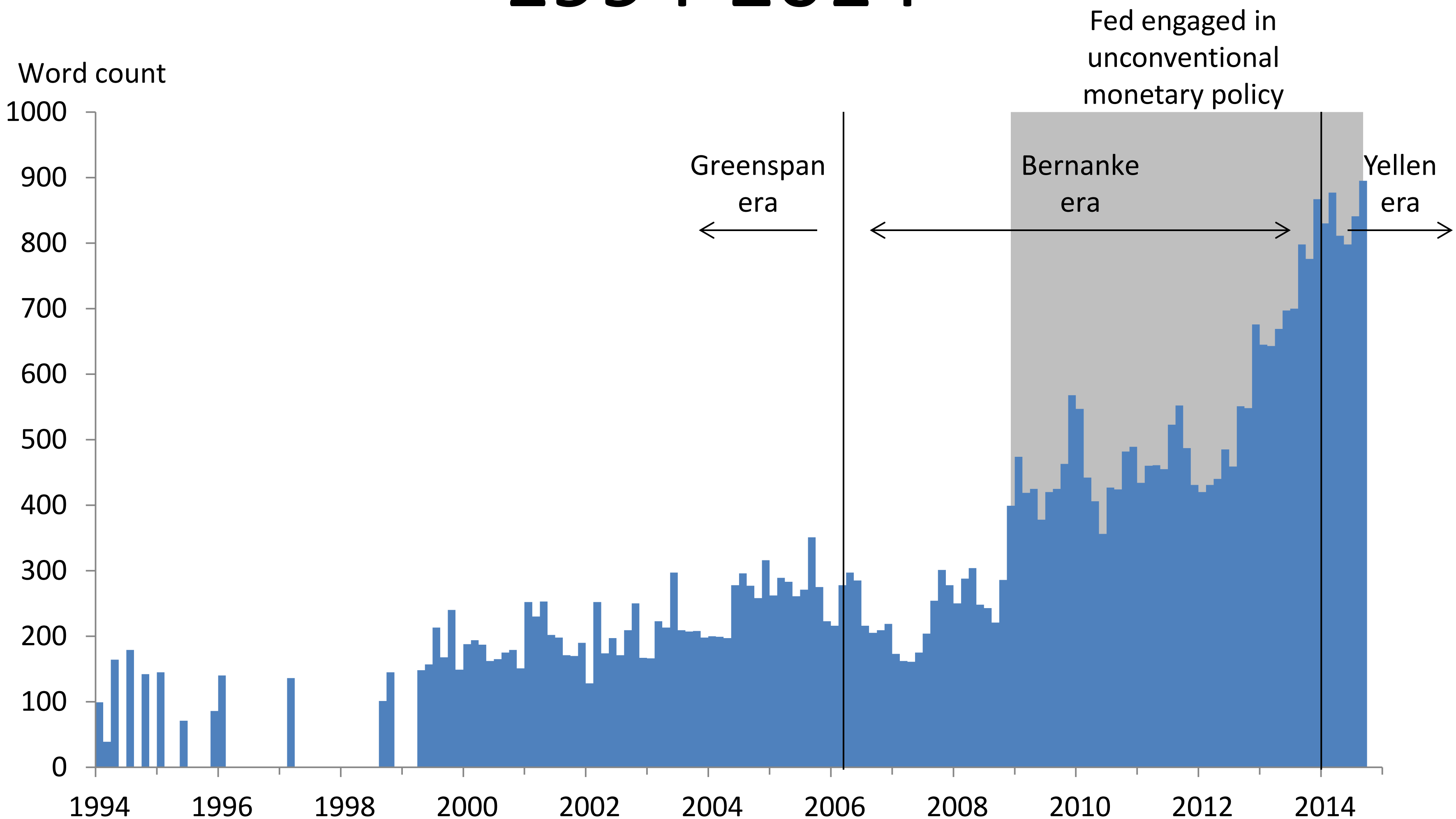
December 2012

- December 2012: switch to <u>state-contingent guidance</u>
  - "…this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6 ½ percent, inflation between one and two years ahead is projected to be no more than a half-percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored."

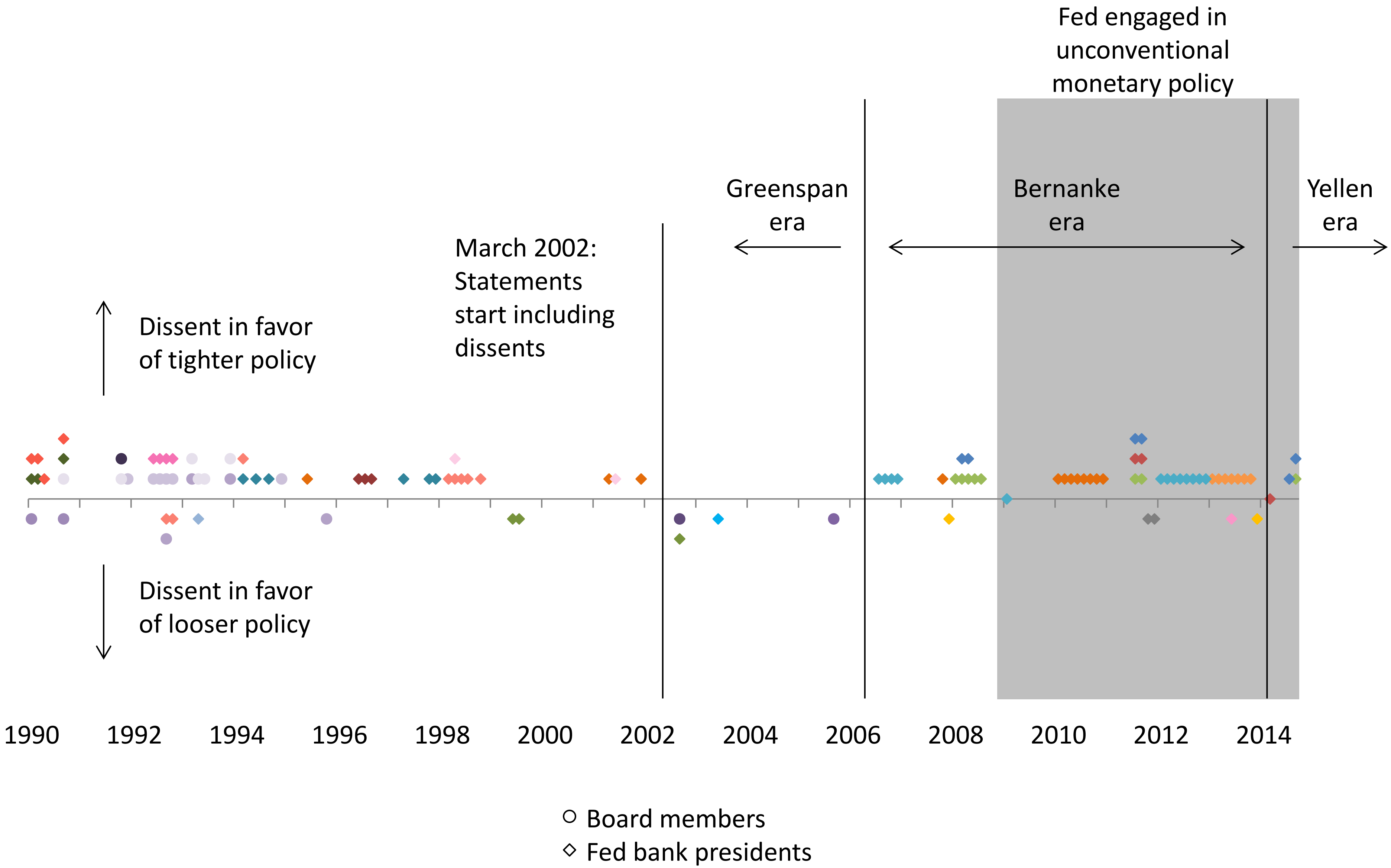
The Yellen era

- January 2014
  - "…it likely will be appropriate to maintain the current target range for the federal funds rate well past the time that the unemployment rate declines below 6 ½ percent…"
  - Unemployment rate down from 6.7 percent in March to 6.3 percent in April
- March 2014
  - "… it likely will be appropriate to maintain the current target range for the federal funds rate for <u>a considerable time</u> after the asset purchase program ends…"
  - Back to time dependent guidance!

Word count of FOMC statements 1994-2014



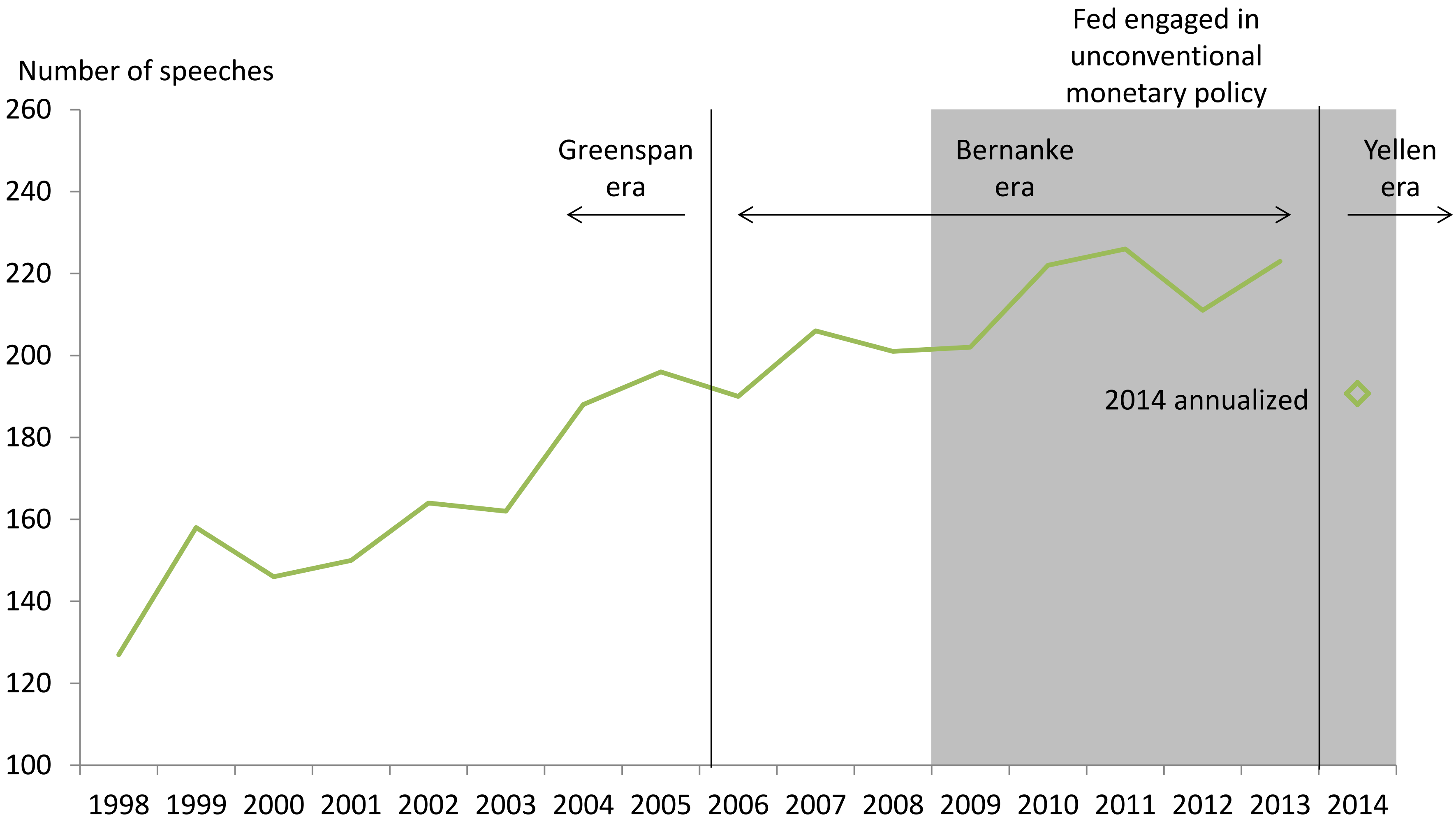
FOMC dissents



Other tools of communication

- Release of minutes
  - Fuller description of the committee's deliberations
  - Now released three weeks after meeting
- Survey of Economic Projections
  - More frequent & detailed
- Chairman's press conference
  - ~4 times a year since April 2011
- Speeches by Governors and Bank Presidents

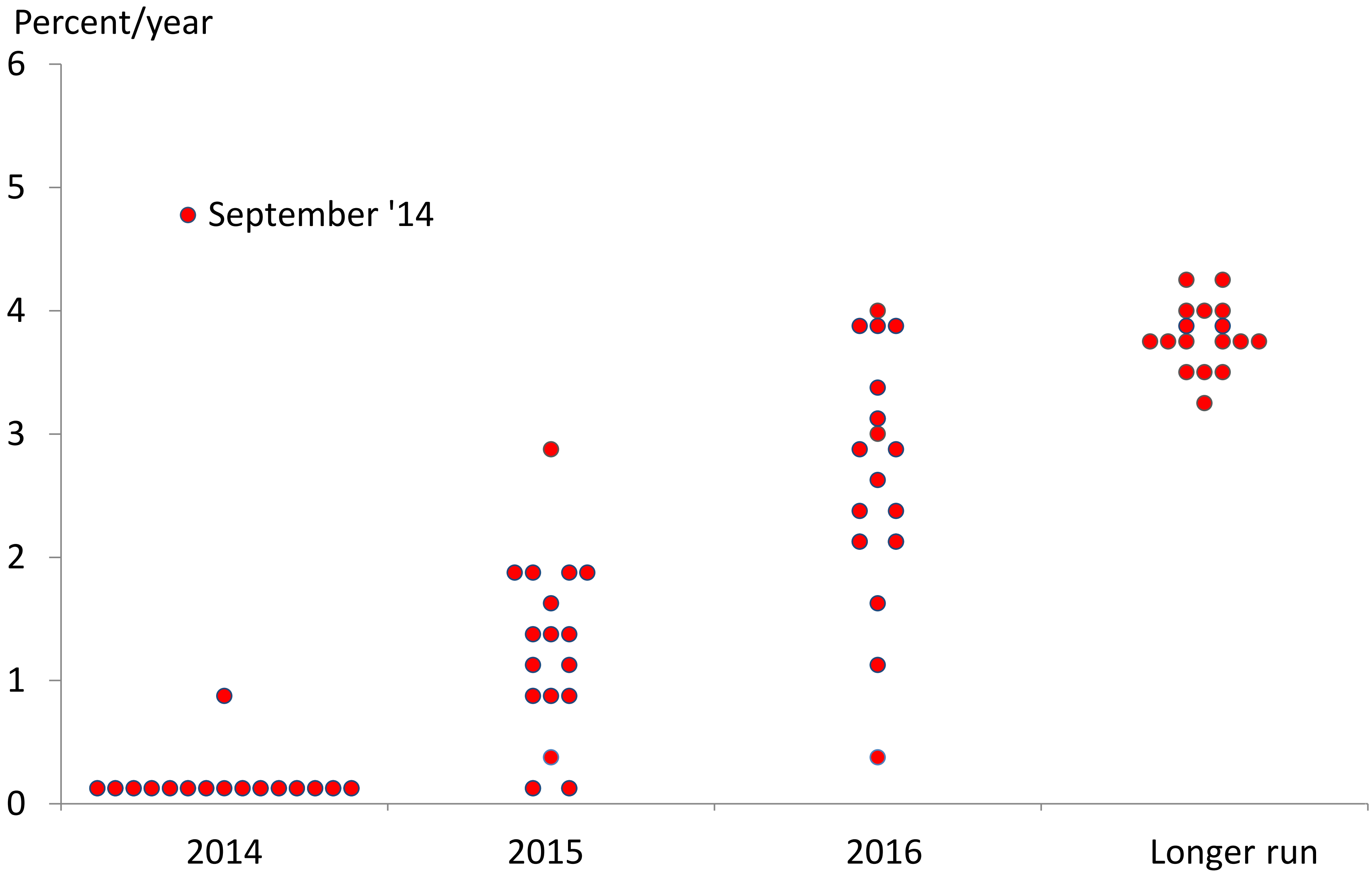
Total FOMC member speeches



Cacophony?

- “An effective committee should resemble the Balkans before a decision is taken, and Switzerland after.”

FOMC participants' funds rate projections



Conclusions

- FOMC communications have undergone a major revolution over the past two decades
  - “Ideas matter”
- Global trend towards greater transparency in monetary policymaking
- Communications matter, especially when interest rates are zero
- Could the FOMC communicate more?

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